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Humpty's Restaurants International Inc.



Annual Report 2006



Corporate Profile

The Company

Humpty's Restaurants International Inc. (HRII or the Company) is one of Canada's leading franchisors of mid-scale full-service family restaurants and one of the nation's few publicly traded franchising companies to focus exclusively on the family segment of the chain restaurant sector.

Corporate Mandate

HRII's corporate mandate is to create enhanced shareholder value by leveraging an inherent operating expertise, superior franchise system and status as a public company to become one of Canada's leading mid-scale family restaurant brand owners and franchisors. To manifest this goal HRII has undertaken an enhanced but managed growth strategy to consolidate the full-service family segment of Canada's foodservices industry.

History

Humpty's Restaurants International Inc. originated October 1990 as Healthy Eating Inc. – a Calgary-based A.S.E. listed Junior Capital Pool (JCP) formed to acquire the shares of Humpty's Egg Place Franchises Inc. The Company is registered as a franchisor in Alberta under the Alberta Franchise Act S.A. 1995 c. F-17.1, and is a reporting issuer to the Alberta and British Columbia Securities Commissions. HRII shares are listed and trading on the Canadian Venture Exchange under stock symbol HMP.

Humpty's Egg Place Franchises Inc. originated in 1982 as a private Alberta-registered franchising company formed to hold all rights, trademarks, assets and franchise privileges attributed and granted to the Humpty's Family Restaurant chain, brand and concept. The company was formed subsequent to being granted franchise privileges by the Alberta Securities Commission in 1982 under the then current Alberta Franchise Act RSA 1980 c. F-17. (See Alberta Franchise Act S.A. 1995 c. F-17.1 for current version.)

Humpty's Family Restaurants originated in 1977 as Humpty's Egg Place an all-day breakfast restaurant created by Don and Jan Koenig, located in the Lower Mount Royal district of Calgary, Alberta. Within six (6) years of initial opening, four (4) additional Egg Places were established as corporate operations. Humpty's Egg Place Franchises Inc. (see above) awarded its first Humpty's Egg Place franchise in 1986 for a outlet to be located in Red Deer, Alberta. Three (3) additional franchises were awarded that year for outlets to be located in the Lethbridge and Edmonton areas of Alberta. In 1988, restaurant operations were renamed Humpty's Family Restaurants to better reflect an emerging focus on family patronage and a menu that included an extensive selection of all-day breakfast, lunch, dinner, appetizer and dessert items. The chain is still most closely associated with its unique breakfast-related menu selections.



President's Message to Shareholders

We are pleased to present to you our Company's operating results for 2006. The positive results reflect our continued efforts to solidify our position in the market place and strengthen our financial status. It is our opinion that 2006 was the beginning of a future of year over year positive financial growth.

Our Operating Results

Total revenue for fiscal 2006 was \$11,325,321 which represents a 34.2% increase from fiscal 2005 (\$8,439,456). The bulk of this increase was derived from the restaurant, gasoline and convenience store division. The change of gasoline brands at our Red Deer AB location increased that locations sales by \$2,788,470 in 2006. Despite five less Franchise locations in fiscal 2006 vs. 2005. Royalty revenue increased 1.5%. Operating expenses increased proportionally with the revenue increase (33.8% vs. 34.2%). Again, as reported for fiscal 2005 "Lease settlements and franchise assistance" were the major contributors to these expenses. The reason we identify this category is because it is the only expense dedicated to troubled locations or rectifying one-time unusual write downs. Although this expense was 9.6% reduced from fiscal 2005 we missed our target of \$395,000 by \$194,165.

The following three unusual items were the write downs that were the major contributors to this expense.

- a) Thunder Bay ON location that closed in January/06. Remainder of lease obligations were \$178,229.
- b) Prince George B.C. lease obligations for fiscal 2006 and part of fiscal 2007 were \$93,529.
- c) Terminated a Franchise location in Edmonton, AB in July/06. The expenses of this closed location to fiscal year-end were \$67,388. This location was renovated and re-franchised in March 2007.

The net effect of the aforementioned unusual items was a loss of \$339,146. Lease settlements and franchise assistance will always be a cost of doing business in our Company however they should never be to the extent that we have experienced over the past five years. Since we don't have any significant lease settlement issues remaining we can project that this category should not exceed \$296,000 for fiscal 2007.



Despite the aforementioned expenses the Company recorded a 53.1% increase of Income from Operations (\$250,477/06 vs. \$163,591/05). Net income improved 133.8%.

Normal Course Issuers Bid

In September 2002 the Company was granted permission to commence a Normal Course Issuers Bid which meant it could repurchase for cancellation up to 759,740 shares of its own capital stock. In September 2003, November 2004, November 2005 and December 2006 the Company renewed its Bid to repurchase its capital stock. Since 2002 the Company has repurchased and cancelled 448,000 of its own shares. Since the end of fiscal 2006 the Company has repurchased an additional 45,000 shares and is awaiting cancellation. With the shares that have already been cancelled or awaiting cancellation it means we have repurchased 3.2% of the original outstanding total. By purchasing these shares for cancellation the Company continues to enhance shareholder value.

Our Market Position

2007 marks the 30th year of the Humpty's System in Canada. Our market share on December 31, 2006 was forty-nine (49) locations operating and one location closed for renovations (re-opened March/07). The Company owns or manages nine (9) locations and has purchased the Nanton, AB location for a corporate takeover May 1/07. This is a prime highway location that will contribute approximately \$1M to our restaurant revenue. The Company also owns a Gas Bar/Convenience Store/Car Wash operation at Gasoline Alley in Red Deer, AB that will generate in excess of \$5M revenue for fiscal 2007.

Looking Forward

Although the Company has decreased in size by eight (8) locations in the past five years the actual annual revenue generated by each Franchise location has increased by 20.4% (\$61,591/06 vs. \$51,151/02). This is a significant increase despite a new reduced Royalty structure implemented in January 2005.

We will maintain our objective to continue to improve on what we have. That is the reason we have continued to upgrade our locations thus improving sales. We will continue to replace under performing Franchise owners (three changes 2006) with more motivated and progressive entrepreneurs.

Although we continue to focus on improvement we will look at every opportunity to develop new locations, particularly in Ontario and the Atlantic Provinces. We know there will be opportunities however the deal has to be right. It's better to be cautious than careless.

Western Canada (particularly Alberta) continues to experience an extreme labour shortage. This is not a short term situation. We are making provisions as are our



Franchisees to bring in foreign workers. To date we have brought in fifteen (15) from Mexico and have another eleven (11) coming from Mexico plus nineteen (19) from the Philippines. We feel we can stay one step ahead of our competition if we can maintain a steady and focused work force.

Summary

If we stay focused on profitability growth we will be prepared for expansion opportunities when they present themselves.

We are proud to be associated with a team of dedicated staff and Franchisees who continually contribute an admirable effort to deliver services that exceed our customers expectations. We acknowledge those staff and Franchisees for their continued commitment and dedication to the Humpty's System. We also appreciate your continued support as shareholders of our Company.

Don Koenig
President and Chief Executive Officer



**KENWAY
MACK
SLUSARCHUK
STEWART_{LLP}**
Chartered Accountants
www.kmss.ca

Humpty's Restaurants International Inc.

Financial Statements

December 31, 2006 and 2005

Auditors' Report

To: The Shareholders of
Humpty's Restaurants International Inc.

We have audited the balance sheets of **Humpty's Restaurants International Inc.** as at **December 31, 2006 and 2005** and the statements of income and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Kennedy Mack Slusarchuk Stewart LLP

March 30, 2007

Chartered Accountants

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Humpty's Restaurants International Inc.

Balance Sheets

As at December 31,

2006

2005

Assets

Current assets

Cash (note 3)	\$ -	\$ 116,770
Accounts receivable	416,176	458,625
Inventory	237,135	229,450
Prepaid expenses and deposits	90,825	76,356
Current portion of notes receivable (note 4)	82,134	81,491
	<u>826,270</u>	<u>962,692</u>

Notes receivable (note 4) 107,920 141,966

Property and equipment (note 5) 3,688,718 3,058,561

Future income taxes (note 9) 462,200 394,400

\$ 5,085,108 \$ 4,557,619

Liabilities and Shareholders' Equity

Current liabilities

Bank indebtedness (note 3)	\$ 256,363	\$ -
Accounts payable	259,519	259,119
Income taxes payable	111,028	70,553
Current portion of long-term debt (note 6)	561,870	556,853
Current portion of capital lease obligation (note 7)	27,070	20,862
	<u>1,215,850</u>	<u>907,387</u>

Long-term debt (note 6) 3,122,755 2,991,847

Capital lease obligation (note 7) 40,235 67,305

4,378,840 3,966,539

Shareholders' equity

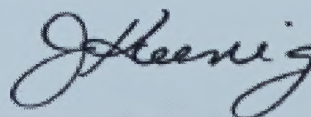
Share capital (note 8)	1,076,021	1,088,741
Deficit	(369,753)	(497,661)
	<u>706,268</u>	<u>591,080</u>

\$ 5,085,108 \$ 4,557,619

Approved on behalf of the Board



Director



Director

See accompanying notes

Humpty's Restaurants International Inc.

Statements of Income and Deficit

As at December 31,	2006	2005
Revenue		
Restaurant, gasoline and convenience store	\$ 8,149,353	\$ 5,163,164
Royalties	1,711,280	1,685,780
Advertising participation fees	752,349	757,286
Rebates and other	592,613	602,277
Rental	114,726	183,949
Franchise sales and renewals	5,000	47,000
	<u>11,325,321</u>	<u>8,439,456</u>
Expenses		
Restaurant, gasoline and convenience store	7,738,216	4,917,830
General and administrative	1,322,695	1,209,298
Advertising and promotion	879,607	870,012
Lease settlements and franchise assistance (note 13)	589,165	651,957
Interest on long-term debt	226,889	343,011
Amortization	318,272	283,757
	<u>11,074,844</u>	<u>8,275,865</u>
Income from operations	250,477	163,591
Other income (expense)		
Loss on sale of property and equipment	-	(676,043)
Income (loss) before income taxes	<u>250,477</u>	<u>(512,452)</u>
Income tax (recovery) (note 9)		
Current	191,744	73,800
Future	(67,800)	(211,900)
	<u>123,944</u>	<u>(138,100)</u>
Net income (loss)	126,533	(374,352)
Deficit, beginning of year	(497,661)	(121,603)
Deficiency (excess) of share repurchase over stated value	<u>1,375</u>	<u>(1,706)</u>
Deficit, end of year	<u>\$ (369,753)</u>	<u>\$ (497,661)</u>
Basic and diluted income (loss) per share	<u>\$ 0.009</u>	<u>\$ (0.025)</u>
Weighted average number of common shares		
- basic and diluted	14,784,441	14,842,275

See accompanying notes

Humpty's Restaurants International Inc.

Statements of Cash Flows

As at December 31,	2006	2005
Operating activities		
Net income (loss)	\$ 126,533	\$ (374,352)
Items not affecting cash		
Losses on lease settlements	61,296	56,350
Amortization	318,272	283,757
Write-off of notes receivable	17,250	162,633
Future income taxes	(67,800)	(211,900)
Impairment write-down of restaurant assets	-	128,000
Loss on sale of property and equipment	-	573,068
	<u>455,551</u>	<u>617,556</u>
Changes in non-cash working capital items (note 10)	<u>61,170</u>	<u>(99,168)</u>
	<u>516,721</u>	<u>518,388</u>
Investing activities		
Principal repayment of notes receivable	94,237	70,632
Notes receivable advanced	(78,085)	(96,956)
Proceeds on disposal of property and equipment	-	2,681,334
Purchases of property and equipment	<u>(767,403)</u>	<u>(456,938)</u>
	<u>(751,251)</u>	<u>2,198,072</u>
Financing activities		
Proceeds of long-term debt	1,790,651	-
Repayment of long-term debt	(1,897,050)	(2,299,962)
Repayment of capital lease obligation	(20,862)	(3,597)
Share repurchase	<u>(11,345)</u>	<u>(8,436)</u>
	<u>(138,606)</u>	<u>(2,311,995)</u>
Increase (decrease) in cash	<u>(373,136)</u>	<u>404,465</u>
Cash (bank indebtedness), beginning of year	<u>116,770</u>	<u>(287,695)</u>
Cash (bank indebtedness), end of year	<u>\$ (256,363)</u>	<u>\$ 116,770</u>
Cash (bank indebtedness) consists of:		
Cash	\$ -	\$ 116,770
Cheques written in excess of deposits	156,363	-
Bank loan	<u>100,000</u>	<u>-</u>
	<u>\$ (256,363)</u>	<u>\$ 116,770</u>

See accompanying notes

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

1. Nature of operations

Humpty's Restaurants International Inc. (the "Company") is incorporated under the Business Corporations Act of the Province of Alberta and is operator and franchisor of Humpty's Family Restaurants and Humpty's Classic Cafes. At December 31, 2006, the Company had 40 franchise locations and 9 corporate locations.

2. Significant accounting policies

(a) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the year. The most significant estimates are for future income taxes, and asset impairment. Actual results could differ from those estimates.

(b) Cash equivalents

The Company considers all investments with maturities of three months or less and demand bank loans that are utilized periodically for day-to-day operations to be cash equivalents.

(c) Inventory

Inventory is recorded at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method.

(d) Impairment of notes receivable

Notes receivable are classified as impaired when, in the opinion of Management, there is reasonable doubt as to the timely collection of principal and interest. The carrying amount of a note receivable classified as impaired is reduced to its estimated fair value.

(e) Property and equipment

Property and equipment are recorded at cost. The Company provides for amortization using the declining balance method at rates designed to amortize the cost of the property and equipment over their estimated useful lives. The annual amortization rates are as follows:

Buildings	4 %
Furniture and fixtures	20 %
Equipment	20 %
Automotive	35 %

Amortization of leasehold improvements is recorded straight line over the remaining term of the lease.

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

2. Significant accounting policies, continued

(f) Impairment of long-lived assets

The Company tests for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability is assessed by comparing the carrying amount to the projected future net cash flows the long-lived assets are expected to generate through their direct use and eventual disposition. When a test for impairment indicates that the carrying amount of an asset is not recoverable, an impairment loss is recognized to the extent carrying value exceeds fair value.

(g) Leases

Leases are classified as either capital or operating leases. Leases that transfer substantially all of the benefits and inherent risks of ownership of property to the Company are accounted for as capital leases. At the time a capital lease is entered into, an asset is recorded together with its related long-term obligation to reflect the acquisition and financing. Equipment recorded under capital leases is amortized on the same basis as described above. Rental payments under operating leases are expensed as incurred.

(h) Revenue recognition

Restaurant, gasoline and convenience store revenue is recognized daily based on cash reports from each location. Royalties and advertising participation fees are based on retail store sales of the franchises and are recorded as earned when collection is reasonably assured. Rebate revenue is recognized in the period that the related purchases of goods are made. Rental revenue is recognized on the first day of each month. Revenue from franchise sales is recognized when the restaurant opens. Revenue received from franchised store locations not opened at year end is recorded as deferred revenue.

(i) Lease settlements and franchise assistance

The Company incurs costs related to assistance for underperforming locations or new locations or to settle leases on store closures. The Company is contingently liable as guarantor under head lease agreements with landlords for many of its franchises. In accordance with CICA EIC-135 "Accounting for Costs Associated with Exit and Disposal Activities", the Company measures costs associated with lease settlements at fair value at the date the Company ceases to use the rights conveyed by the lease.

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

2. Significant accounting policies, continued

(j) Future income taxes

Income taxes are calculated using the liability method of tax allocation accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment occurs. To the extent that the Company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

(k) Income (loss) per share

The Company uses the treasury stock method of calculating per share amounts whereby any proceeds from the exercise of in-the-money stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

(l) Stock-based compensation

The Company has a stock option plan, which is described in Note 8. Options to purchase common shares are granted from time-to-time to directors, officers and employees at current market prices. The Company uses the fair-value method of accounting for stock options granted to employees and directors. Stock-based compensation is recorded in the statements of income as a separate expense for all options granted with a corresponding increase in equity recorded as contributed surplus. Upon exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital.

3. Cash equivalents

An operating line of credit has been authorized by the bank to a maximum of \$100,000 and bears interest at the bank's prime lending rate plus 1.0%; a general security agreement has been pledged as security. \$100,000 is outstanding at year end (2005 – Nil).

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

4. Notes receivable

	<u>2006</u>	<u>2005</u>
Notes receivable from franchisees bear interest at a weighted average interest rate of 8.5%, are unsecured and mature at various dates to 2010.	\$ 190,054	\$ 223,457
Less current portion	<u>82,134</u>	<u>81,491</u>
Due beyond one year	<u>\$ 107,920</u>	<u>\$ 141,966</u>

Principal repayments for each of the next five years are as follows:

2007	\$ 82,134
2008	74,414
2009	29,895
2010	<u>3,611</u>
	<u>\$ 190,054</u>

5. Property and equipment

	2006			2005
	Cost	Accumulated Amortization	Net	Net
Land	\$ 879,968	\$ -	\$ 879,968	\$ 729,968
Buildings	2,307,542	790,388	1,517,154	1,206,582
Leasehold improvements	1,304,434	591,962	712,472	516,341
Furniture and fixtures	948,200	712,007	236,193	223,047
Equipment	921,512	636,487	285,024	304,887
Equipment under capital lease	92,034	36,804	55,230	73,637
Automotive	48,336	45,660	2,676	4,099
	\$ 6,502,026	\$ 2,813,308	\$ 3,688,718	\$ 3,058,561

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

6. Long-term debt

	<u>2006</u>	<u>2005</u>
Mortgages with fixed interest rates ranging from 5.3% to 12% or a floating rate of the bank's variable rate plus 1%, maturing from 2008 to 2021.	\$ 2,486,758	\$ 1,999,466
Loans with floating interest rates ranging from the bank's prime rate plus 1% to 3.5% or a fixed rate of 9.5%, maturing from 2009 to 2011.	407,264	537,443
Notes payable from lease settlements with fixed interest rates ranging from 0% to 15%, maturing from 2007 to 2015 (note 12).	<u>790,603</u>	<u>1,011,791</u>
	3,684,625	3,548,700
Less current portion	<u>561,870</u>	<u>556,853</u>
Due beyond one year	<u>\$ 3,122,755</u>	<u>\$ 2,991,847</u>

Included in mortgages payable is \$300,000 (2005 - \$800,000) due to a company controlled by a director bearing interest at 12%.

Principal repayments for each of the next five years are as follows:

2007	\$ 561,870
2008	420,833
2009	399,247
2010	312,875
2011	253,736
Subsequent years	<u>1,736,064</u>
	<u>\$ 3,684,625</u>

Land and building with a net book value of \$2,401,161 (2005 - \$1,938,791) have been pledged as security for certain of the Company's mortgages payable.

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

7. Capital lease obligation

	<u>2006</u>	<u>2005</u>
Capital leases with a weighted-average interest rate of 13.5%, maturing from 2008 to 2009.	\$ 67,305	\$ 88,167
Less current portion	<u>27,070</u>	<u>20,862</u>
Due beyond one year	<u>\$ 40,235</u>	<u>\$ 67,305</u>
Estimated lease payments are as follows:		
2007	\$ 41,104	
2008	36,267	
2009	<u>10,204</u>	
	87,575	
Less amount representing interest from 19.8% to 29.2%	<u>20,270</u>	
Present value of minimum net lease payments	<u>\$ 67,305</u>	

8. Share capital

Authorized

Unlimited number of Class A voting shares

Unlimited number of first preferred shares, issuable in series

Unlimited number of second preferred shares, issuable in series

Issued

	<u>2006</u>		<u>2005</u>	
	<u>Issued</u>	<u>Amount</u>	<u>Issued</u>	<u>Amount</u>
Common shares				
Beginning of year	14,813,785	\$ 1,088,741	14,848,785	\$ 1,095,471
Shares repurchased	<u>(67,000)</u>	<u>(12,720)</u>	<u>(35,000)</u>	<u>(6,730)</u>
End of year	<u>14,746,785</u>	<u>\$ 1,076,021</u>	<u>14,813,785</u>	<u>\$ 1,088,741</u>

During the year, the Company repurchased 67,000 (2005 – 35,000) of its own shares pursuant to a normal course issuer bid, 32,000 (2005 – nil) of which were cancelled prior to year end. At December 31, 2006, 35,000 (2005 – 35,000) of these shares were held in treasury. Subsequent to December 31, 2006 these shares were cancelled.

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

8. Share capital, continued

Stock options

Under the Company's stock option plan, common share purchase options may be granted to directors, officers and employees. The Company may grant options to purchase common shares up to a maximum of 10% of the number of issued and outstanding common shares. The granted common share purchase options are subject to vesting requirements as determined upon granting and are subject to expiry five years following the date granted.

As of December 31, 2006 and 2005, there are no share options outstanding.

9. Income taxes

(a) The components of future income tax balances are as follows:

	<u>2006</u>	<u>2005</u>
Long-term future income tax asset (liability)		
Accrued liabilities for lease settlements	\$ 105,200	\$ 152,100
Liability for capital lease	21,600	27,800
Tax basis of property and equipment in excess of carrying amount	319,600	196,800
Cumulative eligible capital available for tax purposes	<u>15,800</u>	<u>17,700</u>
	<u>\$ 462,200</u>	<u>\$ 394,400</u>

(b) The provision for income taxes recorded in the financial statements differs from the amount which would be obtained by applying the statutory income tax rate of 32.12% (2005-33.62%) to the income (loss) for the years as follows:

	<u>2006</u>	<u>2005</u>
Income (loss) for the year before income taxes	\$ 250,477	\$ (512,452)
Anticipated income tax expense (recovery)	\$ 80,500	\$ (172,300)
Permanent expense differences	5,500	4,800
Future tax related to tax rate change	18,544	
Adjustment related to tax reassessment	19,400	29,200
Other	<u>-</u>	<u>200</u>
Provision for income taxes	<u>\$ 123,944</u>	<u>\$ (138,100)</u>

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

10. Supplementary cash flow information

Changes in non-cash working capital	2006	2005
Accounts receivable	\$ 42,449	\$ 155,535
Inventory	(7,685)	(6,028)
Prepaid expenses and deposits	(14,469)	(20,538)
Accounts payable	400	(210,732)
Income taxes payable	40,475	(17,405)
	<u>\$ 61,170</u>	<u>\$ (99,168)</u>
Interest paid	\$ 236,492	\$ 346,756
Income taxes paid	157,092	91,205

11. Acquisitions

On November 1, 2006, the Company acquired a franchise location in trouble in Edmonton, Alberta. The results of the restaurant operations have been included since that date. The Company acquired the assets of the franchisee in exchange for assuming debt of the franchisee. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed.

Assets acquired

Equipment	\$ 72,411
Leasehold improvements	<u>108,617</u>
	181,028

Liabilities assumed

Long-term debt	<u>\$ (181,028)</u>
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Net assets assumed	<u>\$ 0</u>
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On December 1, 2005, the Company acquired a franchise location in trouble in Cold Lake, Alberta. The results of the restaurant operations have been included since that date. The previous franchisee retained ownership of the assets and the Company did not guarantee any of the debt. The Company committed to leases for equipment and the building.

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

11. Acquisitions, continued

On August 5, 2005, the Company acquired a franchise location in trouble in Edmonton, Alberta. The results of the restaurant operations have been included since that date. The Company assumed the lease for the building. The aggregate purchase price was \$88,300. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed.

Assets acquired

Inventory	\$ 5,000
Equipment	<u>67,354</u>
	72,354

Liabilities assumed

Long-term debt	(83,300)
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Expense in period

Write down on assets acquired	<u>15,946</u>
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Cash consideration

\$ <u>5,000</u>

On January 19, 2005, the Company acquired a franchise location in trouble in Yorkton, Saskatchewan. The results of the restaurant operations have been included from that date until the location was sold on August 25, 2005. The previous franchisee did not own assets and the Company did not guarantee any of the debt. The Company assumed the leases for equipment and the building until the location was sold.

12. Exit costs

Included in lease settlements and franchise assistance are charges for exit costs, which include future obligations relating to closed corporate and franchise units. As a result of the adoption of EIC-135, discounted liabilities for future lease costs and the fair value of related subleases of restaurants closed after March 1, 2003, are recorded when the restaurant is closed (effective on the cease-use date). All other costs related to restaurant closures, including property taxes and maintenance costs are expensed as incurred.

The estimated liability to the Company for exit costs incurred is included as notes payable in long-term debt (note 6). Reconciliation of the balance as at December 31, 2006, follows:

	<u>2006</u>	<u>2005</u>
Notes payable beginning balance	\$ 1,011,791	\$ 1,255,774
Provision for restaurants closed	117,648	56,350
Payments, net	(376,322)	(335,214)
Accretion (included in interest expense)	<u>37,486</u>	<u>34,881</u>
	<u>\$ 790,603</u>	<u>\$ 1,011,791</u>

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

13. Lease settlements and franchise assistance

Lease settlements and franchise assistance is comprised of:

	2006	2005
Restaurant operations of franchises temporarily under corporate management		
Revenue	\$ (2,529,042)	\$ (1,619,012)
Expenses	2,705,102	1,683,130
Losses on head leases	413,105	564,607
Recoveries on head leases	-	(21,668)
Period costs incurred on closed units	-	19,875
Gain on sale of restaurant assets	-	(102,975)
Impairment write-down of restaurant assets	-	128,000
	<u>\$ 589,165</u>	<u>\$ 651,957</u>

14. Contractual obligations

The Company's total obligations, under various property and equipment lease agreements for the next five years are as follows:

	Gross	Subleases	Net
2007	\$ 3,518,163	\$ 2,896,935	\$ 621,228
2008	3,428,051	2,874,373	553,678
2009	2,897,963	2,608,844	289,119
2010	2,432,492	2,143,906	288,586
2011	1,974,221	1,741,635	232,586
	<u>\$ 14,250,890</u>	<u>\$ 12,265,693</u>	<u>\$ 1,985,197</u>

15. Financial instruments

The Company is exposed to the following risks in respect of certain of the financial instruments held:

(a) Credit risk

Credit risk arises from the potential that a franchise will fail to perform its obligations. In order to reduce its credit risk, the Company monitors credit performance and conducts regular reviews of the franchise's operations. An allowance for doubtful accounts is established based upon factors surrounding the credit risk of specific franchises, historical trends and other information. Under the terms of the franchise agreement, the Company has the right to take over the operations of the franchise in the event a franchise fails to perform its obligations.

Humpty's Restaurants International Inc.

Notes to Financial Statements

December 31, 2006 and 2005

15. Financial instruments, continued

(b) Fair value

The Company's carrying value of accounts receivable, bank indebtedness and accounts payable and accrued liabilities approximates its fair value due to the immediate or short-term maturity of these instruments.

The carrying value of notes receivable approximates fair value as the interest rates are consistent with the current rates offered for debt with similar terms.

The carrying value of the long-term debt, except for non-interest bearing notes payable, approximates the fair value as the interest rates are consistent with the current rates offered to the Company for debt with similar terms. The fair value of notes payable at December 31, 2006, is \$709,935 (2005 - \$882,236), which is based on discounted cash flows using current market interest rates.

(c) Interest rate risk

The Company is exposed to interest rate risk on its floating rate borrowings, as the required cash flows to service the debt will fluctuate as a result of changes in market rates.

16. Additional franchise information

Number of franchise locations

	<u>2006</u>	<u>2005</u>
Beginning of year	45	45
New franchises sold	0	1
Franchises resold by franchisor	0	2
Franchises acquired by franchisor	(1)	(3)
Franchises closed	(4)	
	<u>40</u>	<u>45</u>
Number of franchisor owned locations	<u>9</u>	<u>8</u>
Total locations	<u>49</u>	<u>53</u>

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

April 25, 2007

Management's Discussion and Analysis

The following discussion of the financial position and results of operations should be read in conjunction with the audited financial statements and related notes attached thereto.

Our Business

The Company is one of Canada's leading franchisors of mid-scale full-service family restaurants. It is a franchisor and operator of the Humpty's Family Restaurants chain ("Humpty's").

The Humpty's chain is comprised of full-service family restaurants featuring a full range of breakfast, lunch and dinner items available throughout the operating day. The concept's menu is mid-scale family distinguished by an extensive and unique breakfast-related selection featuring several items original to the chain.

At present, the Company's focus is to grow consistently as a mature and stable organization through restaurant expansion. The Company has had some difficulty over the past few years in its expansions and as such has had to re-evaluate its expansion strategies. These difficulties have brought to light the importance of finding quality locations and qualified franchise owners. As always, a significant amount of emphasis is placed on management support, staff training and local marketing initiatives.

Results of Operations

Analysis of Income for the Year

Revenues

Total revenue for fiscal 2006 was \$11,325,321 which represents a 34.2% increase from fiscal 2005 (\$8,439,456).

The Company continues to operate corporate locations to allow the monitoring of consumer trends and competition, the testing of products and menus, and the refinement of the Company's operations model. Restaurant sales were \$8,149,353 in 2006, an increase of 57.8% from fiscal 2005 (\$5,163,164). The increase in this section was due mainly to the increase in our Red Deer location Gas sales \$3,674,334 in 2006 an increase of 196.8% over 2005.

Royalty fee revenue for fiscal 2006 was \$1,711,280 an increase of 1.5% from fiscal 2005 (1,685,780).

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

Advertising participation fees used to fund corporate advertising campaigns were \$752,349, .007% lower than those of 2005. Rebates and other income totalled \$592,613 down 1.7% from those posted in the prior year.

Rental revenue is generated from rental properties owned by the Company. Rental revenue decreased by 37.6% from the prior year to \$114,726. The significant decrease was caused by the sale of our Red Deer property on October 1, 2005 that included all rental properties.

Franchise sales were \$5,000 and \$47,000 in 2006 and 2005 respectively. In both 2006 and 2005, the Company has taken a cautious approach to expansion due to the difficulties experienced in the expansion into the British Columbia market seven years ago.

Expenses

Corporate restaurant operation costs increased by \$2,820,386 or 57.4% over the previous year, to total \$7,738,216 for fiscal 2006.

Analysis of restaurant operation costs	2006	2005
Food Purchases	1,735,233	1,072,605
Gas Purchases	3,359,154	1,120,455
Salaries and employee benefits	1,463,556	1,320,843
Rents	295,351	195,694
Telephone and utilities	212,872	276,882
Repairs and maintenance equipment and building	141,650	150,301
Advertising Restaurants	247,131	175,605
Miscellaneous	<u>283,269</u>	<u>605,445</u>
Total restaurant, gasoline and convenience store	7,738,216	4,917,830

General and administration expenses totalled \$1,322,695 in fiscal 2006, up \$113,397 from \$1,209,298 posted the prior year. This represents the costs of operating the public company, managing the business and franchise support.

Analysis of General and administrative costs	2006	2005
Salaries and employee benefits	760,203	723,524
Professional fees	130,721	52,904
Franchise support	116,719	119,345
Office and miscellaneous	<u>315,052</u>	<u>313,525</u>
Total general and administrative	1,322,695	1,209,298

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

Advertising and promotion was \$879,607, an increase of 1.1% from 2005 levels. The cost of advertising was in excess of the advertising participation fees of \$752,349 generated from the franchise locations. Management recognizes the key importance of name recognition and as such has continued its efforts in producing effective advertising campaigns.

Analysis of advertising and promotion costs	2006	2005
Advertising national	863,477	850,090
Miscellaneous	<u>16,130</u>	<u>19,922</u>
Total advertising and promotion	879,607	870,012

Lease settlements and franchise assistance represents settlements resulting from store closures and assistance to stores becoming established or re-franchised. Significant losses have been incurred over the past several years due to a number of store closures. Lease settlements and franchise assistance decreased by \$62,792 over fiscal 2005, (\$589,165 in 2006 vs. \$651,957 in 2005).

In 2006, the Company did not add any new franchise locations, closed four franchise locations and bought back one corporately, ending the year with 49 locations.

On January 1, 2006, the Company closed an under performing location in Thunder Bay, ON. Having to move the location from one site to another two years ago resulted in a 50% decrease in sales. The company recorded a loss on head lease for this location of \$178,229.

On January 1, 2006, a location in Red Deer AB, was closed. The location had come to the end of its Franchise Agreement, it was not renewed. The Company has no exposure on the head lease.

In May of 2006, a location in Regina SK, was closed due to a fire. This location will not re-open and the Company has no exposure on the head lease.

In July of 2006, the Company terminated its franchise agreement with a location in Edmonton, AB. To December 31, 2006 the location had a loss on head lease of \$67,388.

In September 2006, the Company, closed a second Red Deer, AB location that was under performing, and is showing a loss on head lease for this location of \$38,091 at December 31, 2006. This location was re-franchised in December of 2006 and to date is experiencing record sales.

In October of 2006, the Company re-acquired a location in Edmonton AB.

Although lease settlements and franchise assistance will always be a part of doing business in our Company these costs should be greatly reduced in the future years.

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

Interest on long-term debt totalled \$226,889, which was a decrease of \$116,122 from 2005 reflecting continued payments on mortgages and loans throughout 2006.

Financial Position and Liquidity

The Company had a stated working capital ratio of 0.68 to 1 at December 31, 2006, down from 1.06 to 1 at December 31, 2005. The debt to equity ratio decreased to 6.20 to 1 from 6.71 to 1 over the same period with available funds being used primarily to repay long-term debt.

In March of 2006 the Company borrowed \$161,800 repayable over 25 years, at an interest rate of 4.15%, on an investment property in Cold Lake, AB. The property is currently generating rental income of \$900 per month.

In September of 2006 the Company borrowed \$237,000 repayable over 25 years, at an interest rate of 5.19%, on an investment property in Calgary, AB. The property is currently generating rental income of \$2,250 per month.

In October of 2006, the Company re-acquired a location in Edmonton, AB. The Company assumed a Royal Bank loan of \$181,028, with monthly principal payments of \$2,980 at an interest rate of prime plus 3%.

In October 2006 the Company refinanced the mortgage on its property at 2505 Macleod Trail South in Calgary, AB with the Business Development Bank. The company borrowed \$1,355,500 in two equal mortgages of \$667,750. Mortgage one has a term of 15 years with principal payments of \$3,710 and an interest rate of 9.0%. The second mortgage also has a term of 15 years with principal payments of \$3,710 per month with interest at 9.3%. The funds were used to pay out the remainder of the mortgage on the Macleod Trail property, a higher interest loan for \$500,000 and to pay out one of the lease settlements in BC.

Risks and Uncertainty

The restaurant and franchise industry is very competitive. Not only are quality locations at a premium, so is the availability of qualified franchisees.

Furthermore, expansion into geographical areas that lack brand recognition for the Humpty's chain creates uncertainty with regards to customer acceptance. The Company researches and evaluates, using strict selection criteria, for each proposed franchise to minimize this risk.

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

The Company has guaranteed leases for a number of Humpty's stores. If franchises, to which the Company is the lease guarantor, are unable to pay their lease obligations, the obligations become that of the Company. Should a lease obligation fall to the Company, it will either negotiate a settlement to end the lease, operate it corporately or re-franchise the store.

Financial instruments

The Company is exposed to the following risks in respect of certain of the financial instruments held:

a) Credit risk

Credit risk arises from the potential that a franchise will fail to perform its obligations. In order to reduce its credit risk, the Company monitors credit performance and conducts regular reviews of the franchise's operations. An allowance for doubtful accounts is established based upon factors surrounding the credit risk of specific franchises, historical trends and other information. Under the terms of the franchise agreement, the Company has the right to take over the operations of the franchise in the event a franchise fails to perform its obligations.

(b) Fair value

The Company's carrying value of accounts receivable, bank indebtedness, accounts payable, accrued liabilities, and income taxes payable approximates its fair value due to the immediate or short-term maturity of these instruments.

The carrying value of notes receivable approximates fair value as the interest rates are consistent with the current rates offered for debt with similar terms.

The carrying value of the long-term debt, except for non-interest bearing notes payable and notes payable with no terms of repayment, approximates the fair value as the interest rates are consistent with the current rates offered to the Company for debt with similar terms. The fair value of notes payable at December 31, 2006, is \$709,935, (2005 - \$882,236), which is based on discounted cash flows using current market interest rates.

(c) Interest rate risk

The Company is exposed to interest rate risk on its floating rate borrowings, as the required cash flows to service the debt will fluctuate as a result of changes in market rates.

Subsequent Events

Subsequent to the end of the year, the Company refurbished and re-franchised a location in Edmonton that had been closed in July of 2006 at a cost of \$136,281. There was a gain of \$9,509 on re-franchising

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

that will be applied to the loss on head lease account showing a small recovery in 2007 for this location. A franchise fee of \$25,000 was also collected and will be recorded in 2007.

Outlook

The Company intends to focus on improving what it has by replacing under performing franchise owners with more motivated and progressive entrepreneurs, while continuing to ensure profitability through support of its core operations. It will cautiously look at every opportunity to develop new locations particularly in Ontario and the Atlantic provinces.

Western Canada, particularly Alberta continues to experience extreme labour shortages. Humpty's has been pro-active in this regard by arranging for an additional 30 foreign workers from Mexico and the Philippines to compliment the current 15 Mexican workers hired in late 2006.

Supplementary Information

Related Party Transactions

As at December 31, 2006 there were no related party transactions.

Share capital

Authorized

Unlimited number of Class A voting shares

Unlimited number of first preferred shares, issuable in series

Unlimited number of second preferred shares, issuable in series

Issued

	2006		2005	
	Issued	Amount	Issued	Amount
Common shares				
Beginning of year	14,813,785	\$ 1,088,741	14,848,785	\$ 1,095,471
Shares repurchased	(67,000)	(12,720)	(35,000)	(6,730)
End of year	14,746,785	\$ 1,076,021	14,813,785	\$ 1,088,741

During the year, the Company repurchased 67,000 (2005 – 35,000) of its own shares pursuant to a normal course issuer bid, 32,000 (2005 – nil) of which were cancelled prior to year end. At December 31, 2006, 35,000 (2005 – 35,000) of these shares were held in treasury. Subsequent to December 31, 2006 these shares were cancelled.

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

Stock options

Under the Company's stock option plan, common share purchase options may be granted to directors, officers and employees. The Company may grant options to purchase common shares up to a maximum of 10% of the number of issued and outstanding common shares. The granted common share purchase options are subject to vesting requirements as determined upon granting and are subject to expiry five years following the date granted.

As of December 31, 2006, there are no share options outstanding.

Normal Course Issuers Bid

In September 2002 the Company was granted permission to commence a Normal Course Issuers Bid which meant it could repurchase for cancellation up to 738,189 shares of its own capital stock. In September 2003, November 2004, November 2005 and December 2006 the Company renewed its Bid to repurchase its capital stock. Since 2002 the Company has repurchased and cancelled 448,000 of its own shares. Since the end of fiscal 2006 the Company has repurchased an additional 45,000 shares and is awaiting cancellation. By purchasing these shares for cancellation the Company is enhancing shareholder value.

Disclosure Controls and Procedures

The Company has established and maintains disclosure controls and procedures. The CEO and CFO of the Company have evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2006 and have concluded that material information relating to the Company and its subsidiaries would be made known to them by others within those entities. There were no changes to the Company's internal controls over the financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting in 2006.

Humpty's Restaurants International Inc.

Management's Discussion and Analysis

Performance at a Glance

5 Year Summary

	2006	2005	2004	2003	2002
Total Revenue	\$11,325	\$8,439	\$8,019	\$8,786	\$9,474
Total Assets	\$5,085	\$4,558	\$7,528	\$7,771	\$8,095
Total Long-term liabilities	\$3,162	\$3,059	\$4,899	\$4,969	\$5,497
Franchises	40	45	45	47	53
Franchisor-owned locations	9	8	6	6	5
Franchise revenue (000s)	\$3,176	\$3,276	\$3,219	\$3,411	\$3,721
Increase (decrease)	(3.0%)	1.7%	(5.6%)	(8.3%)	.76%
Franchise revenue per franchise (000s)	\$79	\$73	\$72	\$73	\$70
EBITDA (000s)	\$796	\$790	\$803	\$587	\$1,047
Net income (loss) (000s)	\$126	(\$374)	\$20	(\$246)	\$111
Earnings (loss) per share, fully diluted	\$.009	(\$.025)	\$.001	(\$.016)	\$.007
Working capital (000s)	(390)	55	(713)	(\$961)	(\$224)
Market price at year end	\$.19	\$.19	\$.16	\$.15	\$.20

Additional information about Humpty's Restaurants International Inc. is filed with the Canadian Securities Commissions, including periodic quarterly reports. Information is also available online at www.Sedar.com.

Humpty's Restaurants International Inc.

Corporate Information

Head Office

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E-mail: info@humptys.com
Website: www.humptys.com

Auditors

Kenway, Mack, Slusarchuk, Stewart
Chartered Accounts
Calgary, Alberta

Legal Council

Corporate Matters:
McLeod & Company
Barristers & Solicitors
Calgary, Alberta

Franchise Matters:
Yuzda Schuster & Bresky
Barristers & Solicitors
Calgary, Alberta

Transfer Agent

Computer Share
Trust Company of Canada
Suite 600 Western Gas Tower
530-8th Avenue
Calgary, Alberta T2P 3S8

Corporate Banking

Bank of Montreal
Calgary, Alberta

Royal Bank of Canada
Calgary, Alberta

Fiscal Year End: December 31st

Board of Directors

Don Koenig*	Chairman President, CEO Humpty's Restaurants Int'l Inc. Calgary, Alberta
Janice Koenig	Vice-President, CFO Humpty's Restaurants Int'l Inc. Calgary, Alberta
Bert Messier*	President BECA International Inc. Calgary, Alberta
Carolyn Messier	Vice-President BECA International Inc. Calgary, Alberta
Albert Jakubec*	Private Investor Calgary, Alberta

*Audit Committee Members

Officers and Executive Management

Don Koenig	President, CEO
Janice Koenig	Vice-President, CFO
Tom Scappatura	Corporate Controller

Annual General Meeting

Thursday, June 28th, 2007
Commencing at 10:00 A.M. @
Humpty's Restaurants International Inc.
2505 Macleod Trail South
Calgary, Alberta

Stock Exchange

Exchange: TSX
Trading Symbol: HMP

